Employees: Invisible Added Value of a Company

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Abstract

In developed economies, where the work input exceeds the physical input, the lack of harmonised and standardised rules of human capital assessment is visible. The mentioned indicates the deficit of an important part of the comprehensive value-added assessment. What do we lose by ignoring the important part of the employee’s value added in the working process? Companies underestimate the employee’s human capital input. Consequently, society typically does not recognize invisible sources of value added in companies. The goals of this article are to highlight the missing human capital (HC) element at the company level assessment and to raise the awareness about its importance. By analysing existing methods of coping with the mentioned challenge, no harmonised solution is evident. By the increasing share of the service sector, emphasis on the HC element should be monitored more closely. The article focuses on the missing and invisible human capital elements in the framework of the value added; it offers suggestions for inclusion of the human capital factor in the process of company’s value added assessment as well as reflections on further steps in this direction.

Keywords: employee, value added, human capital, assessment

Introduction

The researched problem arises from the neglected role of the HC in a company’s value-added assessment. Structural changes require that HC is used in the best possible way to improve productivity and competitiveness at the company level. The mentioned human factor is still not recognised as the key factor in the knowledge society; therefore, it is not managed properly.

Fast technological changes and new business models within dynamic economies influence diverse managerial decisions, including purchases, mergers, and acquisitions of companies. While the business value, according to accounting standards (pure monetary value), is easy to assess, the human capital assets evaluation is in many cases neglected or even omitted (Dean et al., 2012). At the same time, the global economy development focuses on service activities, where the role of human capital is required more than the physical capital once used to be. Human capital is therefore becoming a major source of productivity and, consequently, the major driver of competitiveness. On the other hand, post-crisis evaluations indicate a continuation of a long-term slowdown in the productivity growth, along with a weak level of investments growth. The mentioned might indicate weak human capital management or even neglect of the human factor in the production
process. Furthermore, analysis confirmed that gaps in labour productivity levels among micro, SME, and large firms are relatively high (OECD, 2017a). Due to strong global pressure to keep companies competitive, to attract investors and shareholders, the neglected role and value of human capital within companies’ financial reports is worrisome and not socially responsible. Employers often do not consider HC adequate relevant to be reported in balance sheets (Dean, 2012). This article describes the theoretical background of the topic, existing situation of the human capital assessment at the company level and in the society, reasons to intensity and highlight the role of the human capital, and possible approaches to tackle challenges and conclusions.

### Theoretical Background

Modern globalisation trends, higher competitiveness pressures, and changes in business models create intensive dynamics in management and ownership relations within individual enterprises. There already exists a framework of more–less established and standardized methods of value-added assessment, serving as a basis for diverse transactions, purchases, and sales as well as stock evaluations of a company. However, the value added of the employee within the working process is rarely assessed. In general, economic theory identifies major obstacles to improved human capital information, mostly linked to the issue of intangibility and measurement (OECD, 1996). The mentioned facts cause the deficit of an important part of the comprehensive value-added assessment, excluding the value of knowhow, patents, licences, and goodwill. In any case, the human capital value-added cannot be denied. The World Bank defines a wealth accounting method by measuring human capital (as intangible assets) as the difference between the total wealth and the sum of produced and natural capitals (World Bank, 2006). Another new approach to assess the human capital contribution was published in 2012 by UNU-IHDP and UNEP, based on the “inclusive wealth index.” According to the publication, inclusive wealth is the social value of an economy’s capital assets, which includes, among other components, human capital as a sum of skills, education, and health (UNU-IHDP & UNEP, 2014).

Nevertheless, prevailing methods of monetary measurements related to human capital rely on cost-based and (lifetime) income-based approaches, covered also by SNA and, to certain extent, are comparable. As it is more difficult to find reliable indicators to measure human capital at the national level, the human capital stock assessment at the company level is more visible and provable, last but not the least, by diverse measurement mechanisms, as by human resource accounting (HRA) (OECD, 1996). The company level is also one of places where the human capital potential can be expresses more clearly than simply by formal education as a competence level approximation.

According to the European Commission Annual Report (2017) and due to the crisis, the unemployment gap in the age bracket of 25–39 years is bigger than in the age group 40–64. The mentioned fact might cause a potential decline in the productivity in the future. In the next 25 years, the EU working age population will decline by 0,35%, resulting in lower productivity (EC, 2017). Furthermore, demand and supply mismatches on the EU labour markets indicate insufficient use of the human capital, defined as knowledge, skills, competences, and attributes embodied in individuals (Keeley, 2007). According to Eurofound, 43% of workers in the EU-28 are either under-skilled or over-skilled, and 29% have skills to cope with more demanding tasks (Eurofound, 2016a). Therefore, lower participation in the labour market requires use of existing and not utilised human capital. The main goal of the paper is to highlight the importance of human capital in the working process, to explore existing tools to evaluate wealth of employees at the company level, and to offer further reflections on possible solutions, which would improve the position of human capital as intangible and therefore invisible assets. Slovenia belongs to countries with above-average educational attainment of the younger generation. Despite the mentioned fact, valuation and potential of human capital are deeply underestimated.

### Human Capital: A Neglected Component of the Company’s Assets

The role of labour productivity, which is also due to observed slowdown of productivity in many countries, is strongly emphasized in major economic researches. This trend might predict long-term difficulties to regain higher productivity growth. Analysed in the context of structural weaknesses on the labour market (as demographic changes and skills mismatches), human capital should receive a more serious role in accountancy and financial reports, to be able to offer comprehensive insight into companies’ assets and (long-term) prospects for growth. On the other hand, it is recognised that acquiring knowledge is profitable, as longer life expectancy increases the profitability of the accumulated knowledge (Economist, August 5, 2017). Slovenia is facing labour market weaknesses, declining working age population, and increasing skills mismatches. The need to update existing policies on human capital in Slovenia was stressed recently by the OECD skills strategy (OECD, 2017b).

According to the OECD (2017a), business sector activities (excluding real estate) account for 35–50% of total value
added and of total employment across OECD countries. Increased labour productivity in services requires extensive and permanent investments into the human capital; different levels of investments across countries are observed in increased gaps as a slowdown in a pace of convergence, particularly in the Eastern Europe (GDP per capita convergence). Differences in GDP per capita result from differences in the labour productivity growth and, to a certain extent, from different human capital investments across Europe. The increasing mobility of high-skilled individuals requires socially responsible companies, which enable career progress, lifelong learning, and remuneration for intellectual contributions.

The mentioned process requires progress monitoring and human capital measurement tools. It is necessary to know which individuals contribute most in the working process, which less, to find solutions, how to retain the best employees. If not, a decline in the quality workforce due to unrecognised potentials can lead to lower productivity and lower competitiveness at the company and national levels, to lower motivation for work and to less achievable business goals. The quality of human capital assets is invisible and, in most cases, not appreciated in companies but is taken for granted. In fact, productivity is about how to work “smarter” rather than to work “harder,” as stated by OECD (2015). “Smart” work is considered to be driven by knowledge and innovation and not by intensity of work done.

The management mostly ignores the interconnection between human capital and enterprise outcomes. In the best cases, the human capital remuneration is considered as a cost, being equal to the material cost or service performed (and easy to reduce, when needed). However, this opinion is outdated. The nature of work has changed drastically in the last decades; the role of human capital is increasing and available workforce decreasing. Further on, equalising costs of work with costs of production or services performed cannot be correct; costs cannot be compared. Labour costs do not enable the economy of scale; they cannot be applied to existing standard accountancy framework. In reality, human capital and enterprise goals are interconnected and affect one other (Figure 1). Figure 1 clearly shows that “the management oscillates across processes between corporate goals and human capital management. Therefore, strategic metrics are needed to show the effects of the HC in corporate goals” (Fiz-enz Jac, 2000).

The interdependence between human capital and business goals requires understanding of each important component. It is true that the human capital is difficult to evaluate, but it should not be ignored due to measurement problems. According to Fitz-enz (2000), employee costs can exceed 40% of corporate expenses. Therefore, the return on investments (ROI) of human capital should become an integral and required part of companies’ financial statements and calculated through the new innovative framework. It is important to preserve the best performers in the working process to identify gaps at the productivity level, also due to the shrinking working age population in Europe, as evident from EUROSTAT databases (EC, 2015). The mentioned is even more important for small economies such as Slovenia’s, where human capital stock and its efficient use should prevail upon outdated production to fill outsourcing capacities or declining industries. The monitoring of human capital in companies and assessment of possible future negative consequences of skills

Figure 1. Human Capital and Business Goals

mismatches/deficiencies are further requirements for sustainable productivity growth in Slovenia. In general, the importance of human capital measurement was expressed already in the 1960s and 1970s. However, no unique harmonised and internationally comparable measurement of human capital assets in companies exists. Even worse, according to the survey (Dean, 2012), there exists a broad number of respondents, who consider that human capital should not be accounted for and reported on in balance sheets. Limited literature is available about the human capital assessment challenges at the company level. Existing authors confirm the weak recognition of the HC role, which might cause long-term negative consequences for workers and for the company level efficiency. Do we really live in the twenty-first century and strive to acquire the knowledge economy? It seems that the crisis measures and the economic growth only blur the importance of the human factor in economic growth. Even if the crisis circumstances admitted investments into HC, the crisis was sometimes just an excuse for omitted but necessary investments into skills.

Diffusion of existing and new experimental knowledge and technology is considered one of important channels, through which policies can shape aggregate productivity, also through knowledge transfer and spillovers (OECD, 2015). The comparability of an existing knowledge base should be provided to gain synergies of comprehensive human capital potential. The OECD report from 1998 offered interesting insights about international comparison of human capital investment (OECD, 1998). Lundwall and Johnson (1994) presented interesting and innovative classification of knowledge, divided into four categories of knowledge, namely, I) Know what (refers to facts); II) Know why (refers to knowledge in general, principles and laws in nature, human mind, society); III) Know how (refers to ability); and IV) Know who (refers to social ability to cooperate, communicate with different people and experts).

The most interesting category and the least explored in practice is the last one. Knowing “who knows what” can generate multiplication of knowledge and progress at the company level. Register of the existing knowledge base in HR management is rare, but it can offer an alternate human capital measurement tool. Capability (or attempt) of the human capital monitoring and use of accumulated knowledge within a company indicates adequate managerial practice along socially responsible investments into the human capital. On the other hand, it can prove consequences of human capital investments neglect. In time, companies with a lack of human capital assessment or with human capital gaps will become uncompetitive and not attractive for investors or stakeholders—nor interesting for the best minds and innovative brain circulation. Inadequate investments into skills namely decrease the motivation of existing employees and deter potential job applicants. According to Berkowitz (2001), absence of the modern approach to human capital as valuable assets at the company level is a consequence of the rooted thinking somewhere between the outdated evaluation of industrial work and today’s modern human capital management development. In other words, management and the accounting systems often have an unconscious and tacit mindset that is coloured by the values of yesterday’s industrial age (Berkowitz, 2001). Newer data report that the contribution of the human capital to the organizational success reaches 85%, while the contribution of the financial/material capital reaches only 15% (Bohinc, 2016; Gostiša, 2017). Neglecting human capital no longer makes sense, although it still prevails.

**Why Measure the Human Capital Contribution?**

Without knowing “who possesses what knowledge,” the diffusion of skills and knowledge is underutilised and wasted. The mentioned fact is especially important when talking about working force through the whole life cycle. Individuals change jobs, achieve new skills and competences, many times also in an informal way (as invisible knowledge, soft skills...). Accumulated additional knowledge is often not reflected in educational credentials and therefore does not reflect the actual value of an individual in the working process (OECD, 2001). On the other hand, the mentioned OECD publication emphasizes that a pool of people with low skills remains substantial and includes individuals with relatively high formal educational qualifications (OECD, 2016). In this context, the introduction of “the skills audit” should serve as the first attempt of assessing an individual’s human capital potential. To sum up, skill mismatches without detailed competency analysis hinder productivity growth and efficient skills allocation.

From this point of view, along with a trend of a higher workforce fluctuation in companies, the monitoring and assessment of the existing human capital, possessed in an individual, is even more in demand. The article refers especially to the service sector, where the HC factor is a much more important contributor to company efficiency than the physical capital. In comparison with the past, the knowledge society and its development relies increasingly on human capital.

Human capital stock in individual workers is, namely, not static but changes with different tasks and up-skilling. Further on, according to Liu and Fraumeni, human capital in a wider context also recognises noncognitive skills as intra- and interpersonal skills that have an assumed and increasingly
important role in modern societies (Liu & Fraumeni, 2014). Workers need different skills—not just more skills (OECD, 2016). Additionally, investments into human capital of employees in time present an opportunity cost, which is, in many cases, not rewarded, causing less motivation at work and lower work outcomes. Consequently, human capital as a dynamic element generates upgrading or obsolescence. Demographic changes and less available workforce will make any talent valuable already in the near future. The case of Slovenia with its fast ageing population is even more worrisome, taking into account the neglected role and inefficient use of available human capital (Zupančič, 2016).

The more modern approach to the human capital investment taxation might generate more interest for companies to invest into people and more sensitive workforce treatment. Years ago, Slovenia introduced tax deductions for companies and individuals to promote investments into life-long learning. After abolishing the measure, the significant decrease in investments into skills was noticed. However, in 2012, Slovenia re-introduced tax deductions for R&R investments with a positive trend in investment growth.

Together, with the increased role of the social capital (as mature social relations), human capital is multiplying effects to reach required economic goals. Many elements, linked with human capital and being crucial for company growth, still do not receive equal footing or are not even visible in financial reports/statements. Invisible assets, hidden in individuals can make a substantial difference in productivity growth, if properly identified and used in the working process. Without recognising the insufficient knowledge and inadequate skills in individuals, necessary for productivity boost in the company, the results cannot bring satisfaction to employees or a company. Business goals are lower than they could be with wider insight into all essential components, contributing to the productivity growth and to a healthy economy at the company level. “Knowing who knows what” makes a difference. Measuring knowledge makes the performance improvement possible. Not to forget, there exist diverse tools to measure human capital to enable analysis and measurements. Most measurement models are partial, not harmonised, with the exception of some widely introduced human capital measurements attempts, as OECD comparable statistics on human capital and individual authors draws attention to human capital measurement needs. In practice, human capital analytics does not exist in the majority of companies, hindering cross-company and cross-sector comparisons of human capital capacities. One way to assess the added value of an individual is a comparison between investments into an individual’s human capital in time and productivity growth, taking into account the costs of investments. The simplified comparison can provide insight into the quality change in human capital use. Alternatively, the comparison can confirm the negative consequences of the knowledge atrophy (neglected value-added creation) when not updated. In most cases, the monetary value does not recognise the human capital contribution in the company as an asset; neither the national accounting nor financial statements do either. In reality, nowadays the essential part of the company’s value is present skills and accumulated knowledge. EUROSTAT data confirm the prevailing share of services as a knowledge-intensive sector in the EU (EU-28 73, 9% of the GDP in 2016).

Recognising only one side of the workforce costs analysis, for example, the total cost of workforce metrics (TCOW), as the full cost for people who contribute knowledge to the organization, clouds the clear picture of the workforce’s value added. The same goes to the ratio of the GDP to the public spending on formal education. The foreseen return namely depends on utilization of the human capital and can increase or decrease in time. The fact that a workforce is a company’s most important asset is not reflected in measuring its value added to the company’s wealth. Rewarding human capital at the company level affects productivity of an individual and vice versa. This justification of investments was proved by Woodhall (2001), confirming that investments into human capital is more effective than into the physical capital. A display of the human capital dimension is shown in Table 1.

### Table 1. Human Capital Performance Matrix: Examples

<table>
<thead>
<tr>
<th></th>
<th>ACQUIRING</th>
<th>MAINTAINING</th>
<th>DEVELOPING</th>
<th>RETAINING</th>
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<tbody>
<tr>
<td><strong>COST</strong></td>
<td>Cost per hire</td>
<td>Cost per paycheck</td>
<td>Cost per trainee hour</td>
<td>Cost of turnover</td>
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<td></td>
<td></td>
<td>Cost per employee assistance</td>
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<tr>
<td><strong>TIME</strong></td>
<td>Time to fill job</td>
<td>Time to respond</td>
<td>Cost per trainee hour</td>
<td>Turnover by length of service</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Time to fulfill request</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>QUANTITY</strong></td>
<td>Number hired</td>
<td>Number of claims processed</td>
<td>Number trained</td>
<td>Voluntary turnover rate</td>
</tr>
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<td></td>
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</tr>
<tr>
<td><strong>ERROR</strong></td>
<td>New hire rating</td>
<td>Process error rate</td>
<td>Skills attained</td>
<td>Readiness level</td>
</tr>
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<td></td>
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</tr>
<tr>
<td><strong>REACTION</strong></td>
<td>Manager satisfaction</td>
<td>Employee satisfaction</td>
<td>Trainee responses</td>
<td>Turnover reasons</td>
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Further, the most stable employment relationships in all mobility is gradually replaced by internal mobility. Eurofound data indicate that, in many countries, external transferable skills, which generate with tenure. The mentioned -knowledge. Experienced workers usually acquire transgiving to older workers, who possess adequate skills and side. Even more worrisome is visibly lower attention, perception of the needs and potential from employers’ poor (Eurofound, 2016a). These facts indicate the wrong of workers over 50 years feel their career prospects are job offers good career prospects; on the other hand, 46% according to Eurofound, 38% of workers believe that their -equipment, which is facing a shrinking working age population. The situation is even worse, taking into account that 30% of workers and development in companies is required to receive a full picture of the human capital wealth in one’s company, even more worrisome in the future, which is facing a shrinking working age population. The situation is even worse, taking into account that 30% of people in the EU in age group 20–64 are not in employment (EC, 2017). In general, the knowledge base identification in companies is required to receive a full picture of the human capital potential. Human capital management steps should reveal existing managerial gaps or preventative actions (Figure 2).
As human capital is quite mobile, quality management is becoming a more important factor, contributing to the value-added creation. As the OECD emphasizes, empirical studies provide evidence that stock market valuations are influenced by the extent and type of information on intellectual assets that is publicly disclosed (OECD, 2006). Financial statements without inclusion of the human capital lose a part of the value for the shareholders, leading to wrong recognition of the value at capital markets. Appropriate satellite accounts should raise the invisible company efficiently in the human capital. Therefore, nonfinancial disclosure might promote good managerial practice, inclusive social responsibility, and promising future of the individual company.

Further Research and Challenges Ahead

There exist only limited available and relevant literature, covering the challenge of human capital assessment at the company level. The increasing share of services confirms the important role of the human capital, which should be monitored and assessed to contribute better to business goals.

Further research should explore the following challenges, linked to the human capital dimension and its contribution to company growth:

• Traditional economic performance indicators do not reveal the human capital contribution and distort the picture of the human capital contribution to the company’s outcomes.
• The existing company assessment does not incorporate the human capital factor and therefore does not identify actual human capital deficiencies or unutilised potentials, thus hindering productivity growth at the company level.
• Labour productivity growth in the EU is decreasing; therefore, assessing the human capital component is necessary to evaluate impacts of adequate human capital management.
• Consequently, balance sheets should be modernised and adapted in line with the role and contribution of human capital to recognise the holistic wealth of the company.
• Human capital should not be considered as the company’s cost but as assets, which contribute to business goals, raises innovation, and generates productivity.
• Companies should collect human capital stock information, statistics, and productivity growth reports to better manage investments into the human capital.
• Company success depends in a large part on people with higher levels of individual competence (Kwon, 2009). It is necessary to evaluate the human capital stock in companies, as the human capital is prevailing capital in modern service economies.
Limitations to the topic arise mostly from the HC invisibility and underestimation of its impacts at the company level. Further research possibilities therefore are being directed toward higher awareness raising of employers and national authorities and how to successfully integrate the HC factor and assessment into the harmonised framework. Further, comparisons between socially responsible companies and those neglecting the HC should be highlighted.

Conclusions

Invisible advantages of investments into individual’s human capital often prevent employers from investing in employees, thus causing serious managerial risks. Managerial competences should include also “smart human capital management” together with a “smart human capital allocation.” The first step in this direction requires identification of one’s workforce capacities (potential, actual, or still unutilised one). The mentioned is a prerequisite for increased labour productivity. Knowing a company’s human capital value is important; employing the best performers raises the value added and increases reputation. Monitoring and assessment of human capital positively affects all stakeholders in the working environment. As a result, an employee is appreciated and paid according to the real contribution at work; the company is more competitive and attractive in the business environment; the company is regarded as a socially responsible actor and promoter of knowledge.

Identification of the existing and available workforce enables assessing the potential of companies and better coping with labour skill mismatches, with constraints to higher productivity, with barriers to innovations and with better suitability of skills. A satisfied workforce, which uses human capital in line with capabilities, also means the element of comparative advantage in times of global workforce mobility. The innovation process is increasingly based on collaboration, rapid learning, and networking. In this context, the productivity can be linked with social capital, embedded in norms and institutions, which include public and legal entities (OECD, 2001). Nevertheless, one has to note that measuring social capital is even more complicated than in investing in human capital. Last, but not least, a shift in human capital recognition improves not only productiveness and competitiveness but also higher social inclusion and well-being (OECD, 2001). Human capital and investments into it are recognised as an act of social responsibility toward one’s people and valuable investment for all.

Positive externalities of knowledge and human capital contribute to personal and social improvements. The OECD work has confirmed that improvements in human capital have been one of the key factors behind the growth process in the past decades in all OECD countries, especially in Germany (OECD, 2001). The publication stressed that “there is a need for a call to policy makers to adopt a broader, more inclusive approach to productivity growth that considers how to expand the productive assets of an economy by investing in the skills of the people and providing an environment where all firms have a fair chance to succeed, including in lagging regions” (OECD, 2016).

Therefore, policies at the company level should address potential skill gaps and unutilised potential within companies to improve one’s business performance. The only way to receive relevant information includes quantitative and qualitative monitoring and assessment of human capital the company possess but is, in some cases, unaware of its existence.

Without taking into account the whole context of growth parameters, how does one assess future business growth, along with mid- and long-term business plans? Without a doubt, the human capital in the knowledge economy is becoming a substantial precondition of economic growth. It is socially responsible to recognise the human capital contribution to the economic growth. It is important to include human capital into innovatively adapted balance sheets and to reward its contribution to economic growth.

References


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Zaposleni – nevidna dodana vrednost podjetij

Izvleček

V razvihh državah, kjer doprinos človeškega dejavnika presega fizični kapital, je razvidno pomanjkanje harmoniziranih ter standardiziranih pravil, vezanih na ocenjevanje vloge človeškega kapitala v družbi. Omenjeno dejstvo se navezuje na pomanjkanje vrednotenja človeškega kapitala kot pomembnega dela ocene dodane vrednosti podjetja. Kaj izgubljamo z neupoštevanjem pomembnega dela dodane vrednosti zaposlenega v delovnem procesu? Podjetja podcenjujejo vložek...